TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0551

"Amendments to Operating Margins Pre-emption Rights at LNG Sites"
Version 1.0

Date: 12/06/2002

Proposed Implementation Date:

Urgency: Urgent

Justification

The Network Code rules relating to Operating Margins (OM) requirements for storage capacity and gas are in Section K of the Code. By 1 March in any year Transco have to publish the OM requirements for the following Storage Year and the key assumptions. The Code (K2.1) summarises the purposes for which OM can be used but Transco have considerable scope to refine the Methodology as they consider appropriate.

The majority of the OM requirements are held in Transco's LNG facilities – eg 1067 GWh in 2002/3 of a total OM requirement of 1625 GWh. The OM LNG requirement represents about a quarter of the total LNG capacity available to the industry.

There is no limitation on the volume of LNG capacity, which Transco can choose to book for OM purposes. The existing rules effectively give Transco unlimited pre-emption rights over LNG capacity, including in respect of capacity held by other Users.

These rights are very valuable, and can cause considerable difficulties for other storage users. For example, in 2001 a change in Transco's methodology caused them to increase their "requirements" at one LNG site to such an extent that the capacity left available to other Users was less than the quantity of gas that the other Users had in store at the time the OM quantities were published. Obviously, this can cause a serious problem for other Code Users, potentially creating "distressed sellers" with just one prospective buyer.

It is therefore proposed that the Rules are altered to avoid Users having the risk of becoming exposed to such risks.

Nature of Proposal

The proposed changes are designed to avoid any impact to Transco's Safety Case by maintaining Transco's unlimited "pre-emption" rights. The changes would achieve this by allowing Transco to secure rights to capacity which holds another Users' gas by a form of tender, which would thereby indicate the value of any such pre-emption which Transco decide to exercise.

They are also designed to admit the prospect of varying OM requirements in future years while other Users may have multi-year LNG capacity bookings.

The Proposal would make three changes –

i) Initially Transco would have “free” pre-emption rights in respect of LNG capacity up to a quantity at any site which is the greater of

> the amount of OM gas held in that store at 1 March and
> the capacity at that site available to all Users for the ensuing Storage Year less the total quantity of gas held in store in firm bookings at 1 March by LNG Users other than by Transco for OM purposes

This allows the OM Manager free access to all empty or unbooked capacity (case (b) above). Also, in any case where the capacity available to Users is reduced (as with Grain this year) case (a) ensures that the quantity available to the OM manager is never less than his inventory at that storage facility

ii) If Transco determine that the above is insufficient for the following Storage Year’s OM needs, then Transco would be given scope to “buy” extra pre-emption rights. To this end, Transco would be entitled to publish a tender to buy gas-in-store bundled with capacity rights for the remainder of the current Storage Year. By publishing such a tender Transco would have pre-emption rights to the capacity as defined in (i) and also to the additional capacity holding gas-in-store acquired in the tender process. This places no limit on the extent to which Transco may choose to increase their OM booking for the following Storage Year. The gas acquired would become OM gas in store at the date of acquisition and would reduce the procurement requirements for the ensuing year. This process would mean that a “market price” is determined for the capacity and gas which has to be released to enable the OM booking to be increased. Users should have not less than 7 working days to formulate responses to the tender.

iii) The Code rules need to accommodate the possibility that Transco want additional capacity for OM purposes and publish a tender as above but Users holding such capacity decline to offer sufficient capacity in the tender. In this case, maintaining the integrity of Transco’s Safety Case requires that Transco should have the right to such additional pre-emption as is needed after the tender, irrespective of the impact on other Users and on any ongoing contracts Users may have with Transco LNG.

Thus where Transco seek additional space for OM use, they would in due course need to procure extra gas for this space. Where (but only where) there would be a conflict with other Users’ holdings of gas in store, the proposed process advances the gas procurement to precede any release of LNG capacity to other Users, with the aim that by the time of that release of capacity sufficient capacity would normally remain available to accommodate the total amount of gas.

The above changes would require that any long-term contracts between Transco LNG and their Users admit that capacity may have to be capable of being “clawed back” if the capacity left available after Transco’s OM requirements are secured is insufficient for Transco LNG to honour all ongoing contracts. This has to be borne in mind in structuring future relationships between Transco LNG and their customers but is not a Network Code issue. Also, it is an issue to be addressed whether or not this Modification is implemented.

Purpose of Proposal

This Modification would maintain Transco’s ability to pre-empt LNG capacity for Operating Margins purposes but would ensure Users can achieve a “market value” if other LNG Users collectively ever have to relinquish capacity holding gas to enable Transco to secure sufficient capacity for their OM estimates.

The Proposal is considered urgent because it is desirable to amend the processes before Lattice advance contract terms for LNG services to apply following the proposed separation of Transco LNG from Transco. It is clear that Transco (for Operating Margins purposes) and other Users will have different contract terms, and Lattice have indicated that they would expect these to be based on the Network Code rules prevailing at separation. The proposed implementation date is prior to the date Lattice propose for separation of Transco LNG from Transco, but in any event must be before any separation.

Consequence of not making this change

Users of LNG Services may find there is insufficient capacity available for gas currently held in store, and be forced to become “distressed sellers” with Transco as the a single buyer.

Area of Network Code Concerned

Section K

Proposer's Representative

MIKE S YOUNG

Proposer

British Gas Trading Ltd

Signature